

UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF RHODE ISLAND

UNITED STATES OF AMERICA

v.

CA No. 03-139-T

ROSALINA VERDUCHI,  
DENNIS VERDUCHI, OPTION ONE  
MORTGAGE CORPORATION

**MEMORANDUM AND ORDER**

ERNEST C. TORRES, Chief Judge.

**Background**

The United States brought this action against Rosalina Verduchi and her son, Dennis, in order to recover unpaid taxes allegedly owed by Rosalina and her late husband, Coriolano ("Cal") Verduchi. The government seeks *inter alia*:

1. Judgment against Rosalina for \$397,824.16 in unpaid taxes, plus interest and penalties accrued since March 18, 1993;
2. Authorization to foreclose on a tax lien on the single-family residence located at 10 Chestnut Street, North Providence, Rhode Island, that the government alleges was fraudulently conveyed to Dennis.
3. Judgment against Dennis for \$196,000 plus interest based on the amount that Dennis received when he mortgaged 10 Chestnut Street.

4. Judgment against Dennis for \$83,000 plus interest based on the value of a building at 1190 Douglas Avenue, North Providence, Rhode Island, which the government alleges Cal fraudulently conveyed to Dennis and which Dennis later sold.

After listening to the witnesses and reviewing the exhibits presented at a brief bench trial, this Court finds as follows:

#### **Findings of Fact**

Cal Verduchi operated Cal's Jewelry, a small business that manufactured jewelry. On September 9, 1952, Cal and his wife, Rosalina, purchased a single-family residence at 10 Chestnut Street, North Providence, Rhode Island, where they lived during all of the events that are the subject of this litigation. Cal and Rosalina had three sons, Cal Jr., Anthony, and Dennis, who, when they became old enough, worked in the family's jewelry business.

In the late 1970s, Cal began spending less time in the business and more time at a condominium in Florida that was owned by Lexington Associates, a real estate holding company in which Cal and Rosalina had a 50% ownership interest. Accordingly, Cal gave all but 5% of the stock in Cal's Jewelry to his three sons, in equal shares. Shortly thereafter, Dennis stopped working at Cal's Jewelry and went into the music business with a partner named Steven Bogle ("Steven").

On November 22, 1983, Cal purchased a commercial building at 1190 Douglas Avenue in order to give Dennis a suitable place from

which to operate his music business. Cal paid \$50,000 for the property and it was agreed that, eventually, Dennis and Steven would buy it from Cal for that price. In the meantime, Dennis and Steven each began making payments of \$553.82 per month to Cal. Part of each payment was for rent and the remainder represented a portion of the \$50,000 purchase price.

A few months later, Dennis and Steven borrowed \$100,000 from Security Bank to obtain working capital for their business. Cal and Rosalina also, apparently, signed the promissory note as guarantors.

Since Dennis was no longer involved in Cal's Jewelry, on December 7, 1984, the corporation agreed to redeem his stock for \$250,000. A relatively small portion of the redemption price was paid at that time and the balance of \$231,500 was to be paid in monthly installments over a ten-year period.

Sometime in 1986, Dennis was experiencing financial problems and stopped making payments to Cal for 1190 Douglas Avenue because Steven had left the music business and Dennis was having difficulty making payments on the \$100,000 borrowed from Security Bank.<sup>1</sup> In addition, around the same time, Cal's Jewelry stopped making the monthly payments for the redemption of Dennis's stock because it,

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<sup>1</sup> Dennis estimates that, by that time, he had paid approximately \$10,000 toward the purchase price for 1190 Douglas Avenue, and that Steven had paid about \$5,000 before leaving the partnership.

too, was having financial difficulties.

On March 19, 1987, the IRS issued a Notice of Deficiency to Rosalina and Cal, alleging that they owed more than \$82,000 in federal income taxes because deductions taken by the Verduchis for losses sustained from their investment in a tax shelter called Hampton Associates had been disallowed. The Verduchis filed a petition in the Tax Court contesting the disallowance but, on August 4, 1987, in another case entitled Schwartz v. Commissioner, the Tax Court upheld the IRS's position disallowing losses from investments in Hampton Associates. See Schwartz v. Commissioner, 54 T.C.M. (CCH) 11 (1987).

On September 24, 1987, a little more than a month after Schwartz was decided, Cal conveyed 1190 Douglas Avenue to Dennis and released Dennis from any obligation to pay the balance of the \$50,000 purchase price. While the timing of that conveyance appears suspicious, this Court accepts Dennis's explanation that Cal's motive was to relieve Dennis of some of the financial burden that he faced in paying the balance due on the Security Bank loan and to make up for the fact that Cal's Jewelry had ceased paying Dennis for his redeemed stock. Dennis's explanation is supported by evidence that, at the time the conveyance was made, Cal and Rosalina owned other property having an apparent value much greater than the \$82,000 tax liability asserted in the Notice of Deficiency plus any interest that might have accrued. The Verduchis' property

included their home at 10 Chestnut Street, as well as a 50% interest in Lexington Associates, which owned the Verduchis' Florida condominium, a commercial lot in Cranston, Rhode Island and a duplex in Providence.

In 1988, while an appeal from the Tax Court's decision in Schwartz was pending before the 9<sup>th</sup> Circuit, the Verduchis and the IRS agreed to be bound by the outcome.

In 1990, Cal suffered a stroke which left him disabled and Dennis, the only Verduchi son living with his parents, began helping to care for Cal and began contributing to the family's living expenses.

On April 19, 1991, the Ninth Circuit affirmed the Tax Court's decision in Schwartz and on May 14, 1992, a little over a year later, Cal and Rosalina conveyed 10 Chestnut Street to Dennis. The conveyance was made for no consideration and Cal and Rosalina continued to pay at least a portion of the utility bills and the real estate taxes on the property.<sup>2</sup> The proffered reason for that conveyance, too, was that it was intended to make up for the fact that Dennis never had been paid for the redemption of his stock in

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<sup>2</sup> It is not clear whether Dennis's contributions to the family's living expenses included payments towards the taxes and utility bills. In response to questions by the government's counsel, Dennis testified that his parents paid for the utilities and property taxes before and after the transfer of 10 Chestnut Street. Later, in response to questions by his own counsel, Dennis testified that when his father became ill, he "started to absorb some...like the property tax and stuff." The Verduchis' 1994 bankruptcy schedule shows monthly expenses for utilities and property taxes of \$250 and \$233, respectively.

Cal's Jewelry.

In March 1993, the IRS issued an assessment against Cal and Rosalina for nearly \$400,000 and, in January 1994, it recorded a tax lien on 10 Chestnut Street. Around the same time, Cal's Jewelry was placed in receivership and Dennis was listed as a creditor who was owed \$179,000 which, presumably, represented the balance due for the redemption of his stock.

In January 1996, the Verduchis filed a Chapter 7 bankruptcy petition. Their petition listed, as assets, their 5% interest in Cal's Jewelry and their 50% interest in Lexington Associates. The value of their interest in Lexington Associates was listed as "unknown." The properties at 1190 Douglas Avenue and 10 Chestnut Street, which previously had been conveyed to Dennis, were not listed.

In June 1996, the Verduchis received a general discharge under 11 U.S.C. § 727. In 1998, Cal died. Since then, Rosalina has been living in a nursing home.

In January 1999, Dennis sold 1190 Douglas Avenue to a *bona fide* purchaser for \$83,000 and in November 2002, he obtained a \$196,000 mortgage loan on 10 Chestnut Street from Option One Mortgage Corporation ("Option One"), a financial institution. The government concedes that the tax lien it asserts is subordinate to Option One's mortgage. Dennis, later, used the mortgage proceeds to purchase property in Maine.

## Analysis

### I. Fraudulent Conveyance

Except as provided in 11 U.S.C. § 523, the discharge of a Chapter 7 debtor releases the debtor from liability for any debts, including tax liabilities, incurred before the date of discharge. 11 U.S.C. § 523. Among the debts that § 523 excepts from discharge are debts arising from a tax "with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat." 11 U.S.C. § 523(a)(1)(C). Thus, a discharge does not release a debtor from liability for tax obligations that the debtor sought to evade by fraudulently transferring property prior to filing the bankruptcy petition. In re Macks, 167 Br. 254, 257 (Bankr. M.D.Fla. 1994) ("[I]f the debtor fraudulently transfers property prior to the filing of his bankruptcy petition, § 523(a)(1)(C) operates to deny that debtor a discharge of the debt in controversy.").

In this case, the threshold question is whether the conveyances to Dennis of 1190 Douglas Avenue and/or 10 Chestnut Street were fraudulent. If neither conveyance was fraudulent, the Verduchis' tax liability and any potential derivative liability that Dennis might have as transferee were extinguished by the bankruptcy discharge. On the other hand, if either or both of those conveyances were fraudulent, the bankruptcy discharge would not extinguish the Verduchis' tax liability and Dennis would be

required to return or pay the value of the property fraudulently transferred to him.

The determination as to whether "property of [a] bankrupt has been transferred in fraud of creditors" is made in accordance with applicable state law. Commissioner v. Stern, 357 U.S. 39, 45 (1958); Edelson v. Commissioner of Internal Revenue, 829 F.2d 828, 833 (9<sup>th</sup> Cir. 1987) (determination of fraudulent conveyance and transferee's liability for tax debt was controlled by state law). See Aquilino v. United States, 363 U.S. 509, 512-13 (1960) ("both federal courts and state courts must look to state law" to determine the property interest a taxpayer has in property subject to a federal tax lien).

Under Rhode Island law, a transfer is fraudulent if the conveyance is made (1) with actual intent to defraud, or (2) for less than adequate consideration when, before or after the transfer, the debtor is insolvent. See R.I. Gen Laws §6-16-4 (1956) (1992 Reenactment,); Rhode Island Depositors' Econ. Protection Corp. v. Mollicone, 677 A.2d 1337, 1339 (R.I. 1996) (A transfer is fraudulent if it is made "without fair consideration and the [transferor] was either insolvent at that time or was thereby rendered insolvent."). More specifically, § 6-16-4(a) of Rhode Island's version of the Uniform Fraudulent Transfer Act (UFTA), provides:

**6-16-4. Transfers fraudulent as to present and**



**future creditors.** - (a) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation:

(1) With actual intent to hinder, delay, or defraud any creditor of the debtor; or

(2) Without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor:

(i) Was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction; or

(ii) Intended to incur, or believed or reasonably should have believed that he or she would incur, debts beyond his or her ability to pay as they became due.

Section 6-16-4(b) identifies the factors to be considered in determining whether a transfer was made with actual intent to defraud. It states:

(b) In determining actual intent under subsection (a) (1), consideration may be given, among other factors, to whether:

(1) The transfer or obligation was to an insider;

(2) The debtor retained possession or control of the property transferred after the transfer;

(3) The transfer or obligation was disclosed or concealed;

(4) Before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit;

(5) The transfer was of substantially all the debtor's assets;

(6) The debtor absconded;

(7) The debtor removed or concealed assets;

(8) The value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;

(9) The debtor was insolvent or became insolvent shortly

after the transfer was made or the obligation was incurred;

(10) The transfer occurred shortly before or shortly after a substantial debt was incurred; and

(11) The debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.

R.I. Gen. Laws § 6-16-4 (1956)(1992 Reenactment)

A plaintiff/creditor has the burden of proving by a preponderance of the evidence that a transfer by a debtor is fraudulent. See Nisenzon v. Sadowski, 689 A.2d 1037 (R.I.1997); see also Ed Peters Jewelry Co., Inc. v. C & J Jewelry Co., Inc., 124 F.3d 252 (1<sup>st</sup> Cir. 1997).

The transfer of all of a debtor's property to a spouse, parent, child or other close relative for nominal consideration after a claim has been made against the debtor establishes "a prima facie case of intent to delay, hinder, or defraud" within the meaning of §6-16-4(a)(1). Landmark Medical Center v. Gauthier, 635 A.2d 1145, 1148 (R.I.1994)(citing Savoie v. Pion, 161 A.219, 220 (R.I.1932)).

Moreover, for purposes of § 6-16-4(a)(2), a debtor is deemed insolvent "if the sum of the debtor's debts is greater than all of the debtor's assets at a fair valuation." Nisenzon v. Sadowski, 689 A.2d at 1043 n. 9 (quoting R.I. Gen. Laws §6-16-2(a)). "[T]he mere establishment by a plaintiff that a conveyance was made by an insolvent debtor without consideration [does not] give rise to a presumption that it was fraudulent," Landmark v. Gauthier, 635 A.2d

at 1148 (quoting Ducharme v. Champagne, 292 A.2d 224, 226 (R.I.1972)).

Here, the government argues that the conveyances of 1190 Douglas Avenue and 10 Chestnut Street were fraudulent under both §6-16-4(a)(1) and (2) because they were made with actual intent to defraud and because they were made for no consideration and "after making these transfers, Cal and Rosalina Verduchi were left with huge debts and assets of about \$4,000 in their names." United States pretrial memo, p. 13.

A. Re 1190 Douglas Avenue

The evidence does not support the contention that Cal conveyed 1190 Douglas Avenue with actual intent to defraud. Cal purchased that property four years before the IRS asserted any claim for back taxes; and, when he purchased the property, it was agreed that Dennis would buy it from him by making payments over a period of time. In fact, Dennis did make monthly payments for about two years until his music business floundered. Furthermore, Cal had legitimate reasons for conveying the property to his son. Dennis was struggling financially and Cal's Jewelry had defaulted on its promise to pay Dennis for his stock.

Nor does the evidence support the contention that the conveyance of 1190 Douglas Avenue left Cal and Rosalina insolvent. Although it is clear that the transfer was made "without receiving a reasonably equivalent value in exchange," the government has

failed to sustain its burden of showing that the Verduchis' remaining assets were insufficient to satisfy their obligations. Indeed, it appears that when the property was conveyed to Dennis, the Verduchis still owned their residence at 10 Chestnut Street and had a 50% interest in Lexington Associates which owned other properties, including the Florida condominium, the commercial land in Cranston and the duplex in Providence. Furthermore, Cal conveyed 1190 Douglas Avenue to Dennis approximately six months after the IRS issued its notice of an \$82,909 deficiency, and there is no evidence that the Verduchis had other debts or that the value of the property they still owned was less than their potential tax liability.

B. Re 10 Chestnut Street

The circumstances surrounding the conveyance of 10 Chestnut Street were markedly different. That conveyance was made after the Verduchis' tax liability had been established by the Ninth Circuit's decision in Schwartz, and, by then, the liability had ballooned to \$354,736 due to accrued interest. Furthermore, the Verduchis' financial condition had deteriorated appreciably. Cal no longer had a source of income because he was disabled and Cal's Jewelry was in receivership. In addition, it appears that Lexington Associates was experiencing financial problems because, a year or two later, the Verduchis' counsel informed the IRS that Lexington Associates had debts of \$190,000 and the Verduchis, as

partners, had a negative partner capital account of \$90,000.<sup>3</sup> Finally, although the evidence does not show the exact value of the other real estate owned by the Verduchis when 10 Chestnut Street was conveyed, the bankruptcy petition that they filed three years later indicates that they had total assets of \$4,225.

These facts coupled with the facts that Dennis was the Verduchis' son; the Verduchis continued to live in the home and pay property taxes after the transfer; and the absence of any other plausible explanation for the transfer suggest that the conveyance to Dennis was intended to place 10 Chestnut Street beyond the reach of the IRS. In any event, even if the transfer was not made with actual intent to defraud, it clearly runs afoul of § 6-16-4(a)(2)(ii) because it was made when the Verduchis were insolvent.

## II. The Remedy

1. Under § 523 of the Bankruptcy Act, a discharge does not exempt a debtor from liability for any tax obligations that the debtor sought to avoid by fraudulently conveying property that otherwise would have been available to satisfy those obligations. 11 U.S.C. § 523. Because the transfer of 10 Chestnut Street to Dennis was a fraudulent conveyance, the discharge of Rosina and Cal does not bar the IRS from collecting any taxes that they owe.

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<sup>3</sup> This information was contained in Government Exhibit 10, a 1994 letter from the Verduchis' attorney James Redding to the IRS. Although the letter was not admitted into evidence, it was referred to during the trial.

Since their unpaid tax liability plus interest was, as of March 18, 1993, 397,824.16, judgment will enter in favor of the United States against Rosalina Verduchi in that amount, plus any additional interest that may have accrued since then. In addition, that transfer is declared void and, pursuant to 26 U.S.C. 7403(c), the government may foreclose its lien on 10 Chestnut Street with all amounts in excess of Option One's mortgage being applied toward satisfying the Verduchis' unpaid tax obligations.

Since any amount realized by the IRS upon the sale of 10 Chestnut Street will be diminished by the amount of Option One's mortgage, the proceeds of which were paid to Dennis, judgment may enter in favor of the government against Dennis in the amount of \$196,000 plus interest. See Spaziano v. Spaziano, 410 A.2d 113, 115, (R.I. 1980). (A money judgment against a transferee of a fraudulently conveyed property is appropriate "where such transferee has disposed of or dealt with the property...in such fashion that a return of the property is impossible.") Nisenzon v. Sadowski, 689 A.2d at 1044.

Because the conveyance of 1190 Douglas Avenue to Dennis was not fraudulent, judgment may enter for Dennis with respect to any claim against him based on that conveyance.

#### Conclusion

For all of the foregoing reasons, it is hereby ordered that judgment be entered as follows:

1. Judgment for the government against Rosalina Verduchi in the amount of \$397,824.16 plus accrued interest from March 18, 1993;
2. The conveyance of 10 Chestnut Street is set aside as fraudulent and declared null and void;
3. The government may foreclose on its lien on 10 Chestnut Street and apply the proceeds in excess of Option One's mortgage towards Rosalina's unpaid tax liabilities;
4. Judgment for the government against Dennis Verduchi in the amount of \$196,000, plus interest; and
5. Judgment for Dennis Verduchi on the government's claim with respect to 1190 Douglas Avenue.

IT IS SO ORDERED:

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Ernest C. Torres, Chief Judge  
Date: April           , 2005